No. 77-1171

In the Supreme Court of the United States

OCTOBER TERM, A.D. 1977

ERNEST LaTHROP and MARY D. LaTHROP, individually and as representatives of all persons similarly situated,
Petitioners,

vs.

BELL FEDERAL SAVINGS & LOAN ASSOCIATION,
a corporation organized and existing under the laws of the United States,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes and Regulations

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To The Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, Ernest LaThrop and Mary D. LaThrop, pray that a Writ of Certiorari issue to review the decision of the Supreme Court of Illinois entered on October 5, 1977. A timely petition for rehearing was filed, but denied on November 23, 1977.

OPINIONS OF THE COURTS BELOW

The opinion of the Supreme Court of Illinois (three Justices dissenting, including the Chief Justice) is reported at 68 Ill. 2d 375, 370 N.E.2d 213, (App. I, post). The opinion of the Appellate Court is reported at 42 Ill. App. 3d 183, 355 N.E. 2d 667 (App. II post).

JURISDICTION

The jurisdiction of the Court is invoked under Title 28, United States Code, Section 1257(3).

QUESTIONS PRESENTED

1. Whether mortgage lenders under federally insured home-loan mortgages on federally prescribed mortgage contracts are required to segregate funds deposited with them by home-loan borrowers for taxes and insurance, where the Federal Housing Authority (FHA) pursuant to the National Housing Act of 1934 has mandated that funds deposited for such purposes are to be considered "trust" funds for the benefit of the mortgagors and to be used solely for the purposes deposited?

2. Whether mortgage lenders under federally insured home-loan mortgages are required to account for earnings derived from the use of escrowed funds commingled with the lenders' general funds?

3. Whether the state courts below correctly interpreted the National Housing Act of 1934 and the Regulations of the Federal Housing Authority issued thereunder pertaining to the issues above stated?

STATEMENT

Petitioners are borrowers from a federal savings and loan association under a home-loan mortgage guaranteed by the Federal Housing Authority. Pursuant to the provisions of their mortgage—on a contract form prescribed by the FHA—plaintiffs were required, in addition to their payments of principal and interest, to make monthly deposits to the mortgagee of one-twelfth (1/12) of the annual ground rents (if any), insurance premiums, taxes and assessments. Under the terms of the mortgage and the FHA regulations said sums are to be held in escrow and paid by the mortgagee when due for the purposes stated.

Plaintiffs brought a class action for themselves and in a representative capacity for all other persons similarly situated who borrowed money on mortgage loans insured by agencies of the government (viz., the Federal Housing Authority and the Veterans Administration). The complaint alleged that contrary to the regulations of the FHA, the savings and loan association did not segregate the advance sums deposited and commingled the deposits with its general funds which produced earnings for the lender, and which were retained by the lender for its own account. The suit prayed for an accounting to the plaintiffs of the earnings produced by the improper use of the escrowed funds.

To promote home ownership, deemed by Congress to be a socially desirable objective, the National Housing Act of 1934 (12 USC, §1701, et seq.) was enacted, *inter alia*, for the purpose of enabling persons of low and moderate means to obtain home-loan financing not otherwise available to them in the conventional mortgage market. Under the Act, FHA-approved mortgages are insured against loss on such loans. A federally insured home-loan mortgage is on a prescribed form in national use and uniformly provides that borrowers shall deposit monthly with the mortgage lender one-twelfth (1/12) of the estimated ground rent, insurance premiums, taxes and special assessments and that:

"... such funds [are] to be held by mortgagee *in trust* to pay said ground rents, premiums, taxes and special assessments." (Emphasis added).

The theory of the class action was that the FHA-prescribed form of mortgage mandated and created an *express trust* of the monthly advanced escrow deposits for the benefit of the mortgage borrower. The suit claimed that the defendant lender breached that trust by commingling the monthly escrow deposits with its general funds to generate earnings for its own account. The complaint prayed for an accounting of those earnings. Alternatively, the plaintiffs sought imposition of a constructive trust upon such escrow funds for the benefit of themselves and for all other borrowers similarly situated on the theory that defendant unlawfully converted the earnings to its own use and was unjustly enriched thereby.

The Illinois Supreme Court affirmed a judgment dismissing the action in favor of defendant. The state courts below held that notwithstanding the express language of the mortgage contract, "in trust to pay", an express trust was not thereby created and that the FHA Regulations governing creation and maintenance of advance escrow funds did not require "supervised lenders" (such as defendant) to segregate such funds nor to give an accounting of any earnings derived from the use of such funds.

THE CONTROLLING FEDERAL STATUTE AND THE REGULATIONS AND RULES OF THE FHA:

Section 1709(b)(7) of the National Housing Act (12 U.S.C. §1709) provides that FHA mortgages shall:

"... [C]ontain such terms and provisions with respect to *insurance,* repairs, alterations, *payment of taxes,* default reserves, delinquency charges, foreclosure proceedings, anticipation of maturity, additional and secondary liens, *and other matters as the Secretary may in his discretion prescribe.*" (Emphasis added).

By sections 1701(c)(a) and 1715(b) of the Act the Secretary of Housing and Urban Development is empowered to make such rules and regulations "as may be necessary to carry out his functions, powers and duties." Pursuant to such powers, the Secretary of HUD has done the following:

—(a) Adopted FHA Regulation 24 CFR, §203.23, which in pertinent part provides:

"The mortgage shall further provide that such payment shall be held by the mortgagee in a manner satisfactory to the Commissioner, for the purpose of paying such ground rents, taxes, assessments and insurance premiums before the same become delinquent, *for the benefit and account of mortgagor.*" (Emphasis added).

—(b) Adopted FHA Regulation 24 CFR, §203.7(a)(3) which provides that approval of an FHA mortgagee-lender may be *withdrawn* where the insured lender makes

"... use of *escrow funds* for any purpose *other than that for which they were received;*" (Emphasis added).

—(c) Prescribed the form of mortgage containing the "in trust" language set forth above;

—(d) Uniformly referred to monthly deposits for taxes and insurance, etc., as "escrow" accounts or funds. For example, FHA form No. 2001 entitled "Application for Approval as Mortgagee" states that an applicant for FHA Mortgage Insurance agrees that:

"5. It will analyze mortgagors' *escrow* accounts at least annually." (Emphasis added).

—(e) Issued an FHA Mortgagee's Guide Book (FHA G 4015.9, 1-4a (1970) interpreting FHA regulations and the "in trust" provisions of the FHA mortgage in the following terms:

"(a) The FHA escrow requirements * * * *regardless of the mortgagee's group*, they [i.e., the escrow deposits] may be used *only* for the purpose for which they were collected. Many mortgagors fail to understand this requirement, *which is imposed by both the security instrument and FHA regulations* and cannot be waived, and they believe that the *mortgagee is earning interest* on escrow deposits which are rightfully the property of the mortgagor. *An explanation that it is not possible for the mortgagee to earn interest on escrow accounts* and that the mortgagee, in making monthly collections, performs a service for the mortgagor for which the mortgagee is not reimbursed, might prevent many later questions and misunderstandings."* (Emphasis added).

—(f) With reference to the above-quoted FHA regulations and to FHA mortgages, then Secretary of HUD Romney in answer to a written question by a subcommittee of Congress testified:

* The reference in the foregoing statement to "mortgagee's group" refers to FHA regulations 24 CFR §203.1 and 203.4 which classify FHA approved mortgagees into two groups: the first being mortgagees subject to federal or state supervision and the second being unsupervised mortgagees such as private mortgage lenders. The "security instrument" and "FHA regulations" refer respectively to the FHA mortgage and FHA regulations 24 CFR, §203.23 and 203.27(a)(3), quoted supra.

"'Question 3. On Page 7 of the HUD VA report on mortgage settlement cost, you propose that HUD and the VA see to it that all escrow deposits are kept to a minimum.

"B— Who is the owner of funds deposited in escrow accounts?

"Answer: B. *These funds are owned by the mortgagor* and held in trust by the mortgagee *for the mortgagor's behalf.*"** (Emphasis added).

It is submitted that the Illinois courts completely ignored the intent of Congress to protect home loan borrowers under the National Housing Act of 1934 and have clearly misinterpreted the FHA Regulations and its Interpretative Rules with respect to the handling of the advance escrow funds in question.

** U. S. Congress, House Real Estate Settlement Cost, FHA Mortgage Foreclosures, Housing Abandonment and Site Selection Policies. Hearing on HR 13337, part 1, Feb. 22 and 24, page 239, before Subcommittee on Housing of the Committee on Banking and Currency, 92nd Congress, Second Session.

REASONS FOR GRANTING WRIT

I.

THE QUESTION INVOLVED IS OF PERVADING NATIONAL IMPORTANCE AND AFFECTS THE RIGHTS OF MILLIONS OF HOME LOAN BORROWERS UNDER FHA AND VA MORTGAGES.

The precise question presented in the instant class action is whether the "in trust" provisions of federally insured mortgages create an express trust of the escrow deposits made by home loan borrowers for the purpose of paying insurance, taxes and other items of a similar nature. If, indeed, such funds are "owned by the mortgagor" and held in trust "for the mortgagor's behalf", then it was improper for the savings and loan association to commingle such funds with its own general funds and to retain the earnings without accounting for same.

Such impropriety is not mitigated by the fact that the lender ultimately does pay the taxes and insurance premiums or special assessments for which the deposits were made by the borrower in the first instance. The wrongful conversion is not cured by the restitution and does not erase the breach of the fiduciary duty. Further, the risk of misuse of the converted funds creates the ever present possibility that funds will not be available on due dates for the purposes for which the borrower made the advance deposits—e.g. the insolvency of the lender.

In reaching its conclusion that the sums in question are not in fact trust funds—notwithstanding the express language used—and that the savings and loan association need not account for the earnings generated by the com-

mingled funds, the Illinois Supreme Court relied principally on two cases which are not actually dispositive of the question or supportive of the court's determination: *Brooks* v. *Valley National Bank,* 113 Ariz. 169, 548 P. 2d 1166 (1976) (App. I, pp. 2, 11, 13) was decided on the basis of the bank's affidavit relative to custom and usage and the opinion makes no reference to the pertinent FHA Regulations and Guides. Nor does the opinion show how local custom and usage may nullify a federal regulation governing a federally-insured loan. (It is noteworthy, however, that in a separate concurring opinion, the Chief Justice of the Arizona Supreme Court held that the FHA mortgage did clearly establish an express trust.)

In *Gibson* v. *First Federal Savings & Loan Association of Detroit,* 504 F. 2d 826 (6th Cir. 1974) (App. I, pp. 9, 10) the Sixth Circuit decided the case on the ground that the FHA Guides do not have the force or effect of a regulation. The Michigan court's determination that "there is no regulation which requires supervised institutions to segregate escrow funds", (App. I, p. 9) nor any FHA regulation which prohibits the "practice of using escrow funds for investment purposes" is palpably contrary to FHA Regulation 24 CFR, §2037(a)(3), supra, which subjects the supervised mortgage lender to the risk of withdrawal of approval by FHA if it makes "use of escrow funds for any purpose other than for which they were received."

Moreover, FHA Guide FHA G4015.9, 1-4(a) explicitly states that the prohibition against a mortgagees' earning interest on escrow accounts "is imposed by both the security instrument and FHA regulations". Both the Michigan federal court and the Illinois state court have misapprehended that it is not the FHA Guides which impose the prohibition, but that the guides are expressive of FHA's

interpretation of its own regulations. This Court in *Bowles* v. *Seminole Rock Co.*, 325 U.S. 40, 415 (1945) has held that in construing an administrative regulation:

> "... the ultimate criterion is the administrative interpretation which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."

The national importance and interest of the issues presented by the instant case was remarked by the Illinois Supreme Court in "noting that many cases involving similar questions have been presented to the courts of this State and country in the last decade . . . most of the significant cases have been collected in *Brooks* v. *Valley National Bank* (supra)." (App. I, p. 2). (None of the cases collected in *Brooks,* however involved an FHA mortgage).

Contrary to the conclusion of the majority of the Illinois Supreme Court in the case at bar, cases from other jurisdictions, in various contexts, have held that the phrase "in trust" in the FHA mortgage creates an express trust with all the consequences thereof: viz., *McGhee* v. *Bank of American Natl. Trust & Sav. Assn.,* 131 Cal. Reptr. 482, 60 Cal. App. 3d 442 (1976); *Abrams* v. *Crocker-Citizens National Bank,* 114 Cal. Reptr. 913, 41 Cal. App. 3d 55 (1974); *Liberty National Ins. Co.* v. *United States,* 463 F. 2d 1027 (5th Cir. 1972); *Franklin Life Ins. Co.* v. *U.S.,* U.S. Tax Cases, Vol. 67-2, par. 9515 (U.S. D.C. SD Ill. 1967); *Richmond Hill Savings Bank* v. *Commissioner,* 57 U.S. Tax Repts. 738, 747 (1972); *Boyce* v. *Commercial B & Co. of Albany,* 247 NYS 2d 521 (1964); *Buchanan* v. *Brentwood Federal Savings & Loan Association,* 457 Pa. 135, 320 A. 2d 117 (1974) (involving an FHA mortgage as well as other forms of mortgages). See also *Carpenter* v. *Suffolk Franklin Savings Bank,* 362 Mass. 770, 291 N.E. 2d 609 (1972).

II.

THE POLICY UNDERLYING THE NATIONAL HOUSING ACT AND THE EXPRESSED INTENT OF THE FHA REGULATIONS GOVERNING THE USE OF ADVANCED FUNDS TO BE HELD IN TRUST FOR THE BENEFIT OF THE HOME LOAN MORTGAGOR IS FRUSTRATED BY THE STATE COURT OPINION BELOW.

The dissenting opinion of the Illinois Supreme Court aptly states:

> "The FHA insures mortgages on homes. There is a dollar limitation on the amount of any particular home mortgage which may be guaranteed by it. At present that limit is $45,000 for owner-occupied, single family residences. (12 USC §1709(b)(2) (sup. 1975); 24 CFR 203.18 (1977)). Thus, persons who obtain FHA mortgages are purchasers of non-expensive homes or are of limited means. Savings & loan associations are designed to promote home ownership. (Ill. Rev. Stat. 1975, chap. 32, par. 702 (a); 12 USC §1464 (a) (1970).) It is a recognized fact that banks are not interested in investing in long term mortgages. Hence, the only avenue to borrowers without particular stature at banks has been the savings and loan association, today a vital force in the supply of credit. This, of course, adds up to inequality of bargaining power, a circumstance we cannot disregard. The mortgagors in these FHA loans had no place to go but to the savings and loan lenders. They had to accept the mortgage on the savings and loan association's terms." (68 Ill. 2d 375 at p. 396, App. I, p. 19).

It was the manifest purpose of the National Housing Act and the explicit intent of the FHA Regulations, supra, to protect beneficial ownership in the escrow funds paid under a federally-insured mortgage and to impose fiduciary

obligations on the "supervised" lender in its stewardship of those funds. Citizens in every state of the Union numbering in the millions, who are home loan borrowers under federally insured mortgages have a definite stake in the determination of the issues here presented. The conflicting decisions in the state courts and the federal circuits as to whether the "in trust" provision of the uniform type FHA mortgage imposes recognized fiduciary obligations upon the "trustee" merits resolution by this Court.

CONCLUSION

For all of the foregoing reasons, it is respectfully prayed that a Writ of Certiorari issue to the Supreme Court of Illinois.

Respectfully submitted,

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APPENDIX

APPENDIX I

Opinion of the Supreme Court

MR. JUSTICE MORAN delivered the opinion of the court:

The plaintiffs, Ernest and Mary La Throp, sought to represent a class of mortgagors whose mortgages from the defendant, Bell Federal Savings and Loan, are insured by the Federal Housing Authority (FHA) or the Veterans Administration (VA) and whose contracts, on FHA- or VA-prescribed forms, provide that the mortgagee will hold certain tax and insurance funds "in trust to pay" tax and insurance obligations of the mortgagor. They claim that, under the terms of their mortgage contract, an express trust for the benefit of the mortgagors was created as to such funds, in violation of which the defendant has commingled the funds with its general funds, has earned large profits from investment thereof, and has never paid the plaintiffs or made an accounting to them for their *pro rata* share of these earnings. Instead, plaintiffs assert, defendant has wrongfully appropriated these earnings for its own use. Plaintiffs ask an accounting for these earnings. Alternatively, the plaintiffs seek imposition of a constructive trust upon the funds, on the theory that defendant unlawfully converted the earnings and was unjustly enriched thereby. The defendant denied that it is a trustee, as claimed by the plaintiffs, admits that it commingles the funds, and asserts by way of affidavit that it has a legal right to treat the funds as its own, and that in so doing it follows the long-standing practice in Illinois and elsewhere with regard to such funds.

Without reaching the question of the propriety of a class action herein, the circuit court of Cook County sustained defendant's "motion for judgment on the plead-

ings or in the alternative for summary judgment or in the alternative to dismiss." The appellate court affirmed (42 Ill. App. 3d 183), and we here affirm.

It is worth noting that many cases involving similar questions have been presented to the courts of this State and country in the last decade. Because of differences in the specific language of the mortgage contracts and because of the different posture of the cases on the pleadings and on appeal, we deem none of them dispositive of the issues herein. Most of the significant cases have been collected in *Brooks* v. *Valley National Bank* (1976), 113 Ariz. 169, 171, 548 P.2d 1166, 1168.

The plaintiffs assert that certain FHA regulations and interpretations make erroneous the appellate court's finding that the mortgagee's language, "in trust to pay," did not create an express trust between mortgagor and mortgagee, and further that the appellate court erred in holding that the plaintiffs' complaint fails to state a cause of action for the imposition of a constructive trust. In this regard, it is urged that the complaint adequately alleges that defendant has been unjustly enriched by the breach of a fiduciary duty it owed plaintiffs, which breach warrants the imposition of a constructive trust upon the advance funds in the hands of the defendant. On cross-appeal the defendant urges that this suit cannot be maintained as a class action, and that the Federal Home Loan Bank Board has primary jurisdiction of the subject matter of plaintiffs' complaint.

To determine if an express trust has been created, a court must look beyond the mere use, or absence of, the word "trust." (*Oglesby* v. *Springfield Marine Bank* (1946), 395 Ill. 37, 49; Restatement (Second) of Trusts sec. 24(2)

(1959).) Critical to the creation of a trust is the expressed intention to create a relationship constituting a trust. (Restatement (Second) of Trusts sec. 23, comment *a* (1959).) The intent of the parties to a contract must be determined with reference to the contract as a whole, not merely by reference to particular words or isolated phrases, but by viewing each part in light of the others. *Martindell* v. *Lake Shore National Bank* (1958), 15 Ill. 2d 272, 283.

Having viewed the mortgage contract as a whole, we deem the following to be the relevant provisions. The plaintiffs promise:

> "That, together with, and in addition to, the monthly payment of principal and interest payable under the terms of the note secured hereby, the Mortgagor will pay to the Mortgagee, on the first day of each month until the said note is fully paid, the following sums:
>
> (a) An amount sufficient to provide the holder hereof with funds to pay the next mortgage insurance premium if this instrument and the note secured hereby are insured, or a monthly charge (in lieu of a mortgage insurance premium) if they are held by the Secretary of Housing and Urban Development, as follows:
>
> (I) If and so long as said note of even date and this instrument are insured or are reinsured under the provisions of the National Housing Act, an amount sufficient to accumulate in the hands of the holder one (1) month prior to its due date the annual mortgage insurance premium, in order to provide such holder with funds to pay such premium to the Secretary of Housing and Urban Development pursuant to the National Housing Act, as amended, and applicable Regulations thereunder, or
>
> (II) If and so long as said note of even date and this instrument are held by the Secretary of Housing and Urban Development, a monthly

charge (in lieu of a mortgage insurance premium) which shall be in the amount equal to one-twelfth (1/12) of one-half (½) per centum of the average outstanding balance due on the note computed without taking into account delinquencies or prepayment;

(b) A sum equal to the ground rents, if any, next due, plus the premium that will next become due and payayble on policies of fire and other hazard insurance covering the mortgaged property, plus taxes and assessments next due on the mortgaged property (all as estimated by the Mortgagee) less all sums already paid therefor divided by the number of months to elapse before one month prior to the date when such ground rents, premiums, taxes and assessments will become delinquent, such sums to be held by Mortgagee *in trust to pay* said ground rents, premiums taxes and special assessments; and

(c) All payments mentioned in the two preceding sub-sections of this paragraph and all payments to be made under the note secured hereby shall be added together and the aggregate amount thereof shall be paid by the Mortgagor each month in a single payment to be applied by the Mortgagee to the following items in the order set forth:

(I) Premium charges under the contract of insurance with the Secretary of Housing and Urban Development, or monthly charge (in lieu of mortgage insurance premium), as the case may be;

(II) Ground rents, if any, taxes, special assessments, fire and other hazard insurance premium;

(III) Interest on the note secured hereby; and

(IV) Amortization of the principal of the said note.

Any deficiency in the amount of any such aggregate monthly payment shall, unless made good by the Mortgagor prior to the due date of the next such payment, constitute an event of default under this mortgage. The Mortgagee may collect a 'late charge' not to exceed two cents (2¢) for each dollar ($1) for each payment more than fifteen (15) days in arrears, to cover the extra expense involved in handling delinquent payments." (Emphasis added.)

Paragraphs (a) and (b) above dealt with the advance funds in question here, and paragraph (b) specifically uses the term "trust." However, there is no express provision in the contract indicating that the plaintiffs intended that the defendant should segregate the advance funds from its general account, nor is there any provision requiring defendant to pay plaintiffs earnings on such funds. (Likewise, there is no language manifesting agreement that defendant would pay plaintiffs interest on such funds. This is not determinative, however, as the presence of such language would tend to negate the intention to create a trust and is more in keeping with the creation of a debtor-creditor relationship. Restatement (Second) of Trusts sec. 12, comment *g* (1959).

Counterbalancing the use of the word "trust," section (c) requires plaintiffs to make the monthly advance payments stated in paragraphs (a) and (b) in an aggregate sum with the principal and interest due on the note. The second sentence of (c)(IV) makes any deficiency in the payment of the above aggregate sum (absent timely cure) an act of default under the mortgage. The final sentence of that section provides for the assessment of a late charge for failure to make the aggregate payment on time. These provisions are indicative of the creation of a debtor-creditor relationship with respect to the advance funds, and that relationship is inconsistent with the existence of a trust as to the same funds. (See Restatement (Second) of Trusts

sec. 12 (1959). See generally *Kilgore* v. *State Bank* (1939), 372 Ill. 578, 584-85.) We therefore find that the express terms of the mortgage document are ambiguous as to the intention to create a trust.

When the terms of a contract are plain, the instrument itself is the only source of intent of the parties. (*Decatur Lumber & Manfacturing Co.* v. *Crail* (1932), 350 Ill. 319, 323-24.) However, where there is an ambiguity arising from the terms of the contract, the meaning may be derived from extrinsic facts surrounding the formation of the contract. 4 Williston, Contracts sec. 629, at 923 (3d ed. 1961).

The plaintiffs assert that extrinsic evidence regarding the contract formation supports a finding of intent to create a trust. Plaintiffs have argued at length that, in essence, the defendant's intent to create a trust was implicit in its use of the word "trust" because of the existence of certain FHA regulations and interpretations, and because, by the terms of defendant's original application to the FHA for acceptance as an insured mortgagee, the defendant agreed to "analyze mortgagors' escrow accounts at least annually." The defendant therein further agreed to comply with the provisions of the FHA regulations and other requirements of the Federal Housing Commissioner. In a slightly different vein, plaintiffs urge that, in the contract with plaintiffs, defendant was bound by the FHA regulations which have the force of law; that these regulations are to be given the interpretation of the agency charged with their administration, and such regulations and interpretations establish that the advance funds were to be segregated funds, in escrow, used only for the designated purposes and held for the benefit of the plaintiffs.

It is undisputed that Federal regulations may have the force of law with regard to regulated groups, and that the defendant was entitled, by 12 C.F.R. section 545.6—11, to collect the subject advance funds. This same Federal Savings and Loan System Regulation provides that all loan instruments shall comply with applicable provisions of law, government regulations, and the Federal association's charter. FHA regulation (24 C.F.R. sec. 203.23) provides that the terms of the insured mortgage "[s]hall further provide that such [advance] payments shall be held by the mortgagee in a manner satisfactory to the Commissioner for the purpose of paying such ground rents, taxes, assessments, and insurance premiums before the same become delinquent, *for the benefit and account of the mortgagor.*" (Emphasis added.) It is asserted that these regulations bind the mortgagee to the creation of a trust of the advance funds "for the benefit and account of the mortgagor." Laying aside, for the moment, the implicit assertion that Federal regulations can substitute for the intent of the private parties to a contract and bind them to the creation of a trust, we believe that the plaintiffs misinterpret the import of the phrase, "for the benefit and account of the mortgagor." As we interpret it, this phrase does not relate back to the words "shall be *held* by the mortgagee" (emphasis added), but instead relates back to the word "paying." Thus, the mortgagee is to have funds to pay, for the benefit and account of the mortgagor, the taxes, insurance, etc. Our conclusion that this regulation does not dictate imposition of a trust is supported by the addition, in 1975, of 12 C.F.R. section 545.6—11(c), which makes clear that on certain loans made on or after July 16, 1975, a Federal association shall pay interest on the escrow account *if* there is in effect *a specific State statutory provision* for such, and that, "'"[e]*xcept as provided by*

contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph." (Emphasis added.)

The only other FHA regulations which are asserted to support the intention or legal obligation of the creation, under the mortgage, of a trust for the advance funds is found in 24 C.F.R. section 203.7, which provides in pertinent part:

> "(a) Approval of a mortgagee may be withdrawn at any time by notice from the Commissioner, by reason of:
>
> • • •
>
> (2) The failure of a nonsupervised mortgagee to segregate all escrow funds received from mortgagors on account of ground rents, taxes, assessments and insurance premiums, and to deposit such funds to a special account or accounts with a financial institution whose accounts are insured by the Federal Deposit Insurance Corporation or by the Federal Savings and Loan Insurance Corporation;
>
> (3) The use of escrow funds for any purpose other than that for which they were received."

The plaintiffs assert that the use of the word "escrow" in section (3) indicates that a trust was to be created with respect to the advance funds. Without delving into the differences between an escrow and a trust, we point out that the mere use of the word "escrow" is, of itself, no more determinative of the creation of a trust relation than the use of the word "trust," as indicated above. Additionally, section (2) above, which requires segregation of advance funds, deals only with nonsupervised lenders. It is uncontroverted that, pursuant to FHA regulation (24 C.F.R. section 203.4), the defendant herein is a supervised

lender. As such, it is not subject to the terms of section 2. "[T]here is no regulation which requires supervised institutions to segregate escrow funds." (*Gibson* v. *First Federal Savings & Loan Association* (6th Cir. 1974), 504 F.2d 826, 829.) The district court of Michigan pointed out in *Gibson* that section (3) does not expressly prohibit the practice of using escrow funds for investment purposes. It observed:

> "Rather, it prohibits application of the funds for purposes different from that for which they were received. Plaintiffs do not dispute that [defendant] pays the taxes and insurance premiums with the escrow funds and that any excess it collects over the amount actually paid out for taxes and insurance is credited for future payments of these items. Thus, the escrow funds are used exclusively for the purpose for which they were received." (Footnote omitted.) *Gibson* v. *First Federal Savings & Loan Association* (E.D. Mich. 1973), 364 F. Supp. 614, 616.

We deem it significant that 24 C.F.R. section 203.7(a) appears, on its face, to regulate the relationship between mortgagee and FHA, rather than the relationship between mortgagee and mortgagor, for it provides that approval of the mortgagee may be withdrawn for failure to comply with the provisions thereof, but section (b) thereto provides that "[w]ithdrawal of a mortgagee's approval shall not affect the insurance on mortgages accepted for insurance."

The plaintiffs strongly urge that the terms of the regulations above must be construed in light of the FHA's own applicable interpretations. Plaintiffs cite numerous sections of the FHA's interpretive Mortgagee's Guide, published in April of 1970. Insofar as the interpretations therein were published almost a year after the date of the mortgage contract herein, such interpretation can in no

way be deemed to have controlled the intent of either party to the contract at the time of its formation. Furthermore, it is undisputed that administrative interpretations (as distinguished from administrative regulations) do not have the force and effect of law. In *Gibson* v. *First Federal Savings & Loan Association* (6th Cir. 1974), 504 F.2d 826, 830, which refers specifically to the Mortgagee's Guide and certain opinions of departmental counsel, it has been held that "such statements and opinions do not have the force or effect of regulations."

As a supervised lender, the defendant is subject to the control of the Federal Home Loan Bank Board, whose regulations "do * * * appear to authorize the complained of practice." (*Kinee* v. *Abraham Lincoln Federal Savings & Loan Ass'n* (E.D. Pa. 1973), 365 F. Supp. 975, 978.) The court in *Kinee* points out that even if those regulations did not specifically authorize the practice, "the plaintiffs would still be in the position of never having brought to the Court's attention any provision of the Homeowners Loan Act or of the regulations promulgated pursuant thereto which forbid the practice and therefore might arguably create a cause of action for following the practice" (365 F. Supp. 975, 978.) As the Mortgagee's Guide was published after the formation of the contract in question, and as the applicable FHA regulations do not clearly require the creation of a trust, we believe the plaintiffs' reliance upon the FHA regulations and interpretations in the construction of this contract is misplaced.

Furthermore, even if plaintiffs are correct in their contention that the FHA regulations and the Mortgagee's Guide have the purpose of imposing a trust upon the advance funds, we deem it clear that in an action between a mortgagor and mortgagee (not between the mortgagee

and FHA), where the mortgage contract does not specifically incorporate the FHA regulations or expressly indicate agreement thereto, such regulations are not determinative of the content of the contract created between the parties. Once again, the intention of the parties thereto is paramount. No intention to so incorporate FHA regulations is discernible from the mortgage document.

An affidavit by William C. Prather, general counsel for the United States Savings and Loan League, states in support of the defendant's motion that it is, and it has for many years been, common practice in the savings and loan business in Illinois and throughout the United States to commingle the lender's general funds and the mortgage loan payments—including the required advance payments for taxes and insurance—and to distribute no earnings or interest earned on such advance funds to the mortgagors. This custom and usage has been noted elsewhere in a similar case where, in a specially concurring opinion, Vice Chief Justice Struckmeyer observed in *Brooks* v. *Valley National Bank* (1976), 113 Ariz. 169, 175-77, 548 P.2d 1166, 1172-74:

> "The majority have cited to ten lawsuits which have been brought against lending institutions in various courts of this country to compel reimbursement for the use of impound funds, or what is usually described as escrow funds. * * * [These cases] * * * establish a usage, the customary practice by lending institutions in the United States. Without exception, interest was not paid nor were the earnings on the investment of the impound funds credited to the mortgagor.
>
> * * *
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> The practice of requiring impound payments has existed since the early 1930's. In every instance, without exception, where a suit has been brought to compel payment of interest or the earnings on the invest-

ment of the impound funds, the lending institution has not paid the mortgagor for the use of the impound funds. Nor is there anywhere the slightest suggestion that the Valley National Bank or any lending institution ever paid for the use of impound funds.

While a few isolated instances will not prove a usage, one so firmly established for so many years nationwide should be controlling. A usage will be binding if it is uniform, long established, and so well known that it can be said that the parties contracted with reference to it and the failure to conform to it would be the exception. *Cleveland etc. R.R. Co.* v. *Jenkins,* 174 Ill. 398, 51 N.E. 811. Nor is a usage invalid because its effect is different from a general rule of law.

> 'It is well settled that a trade usage which is contrary to a statute or which contravenes public policy is invalid and may not be invoked; but where a rule of law is of a character that the parties may make it inappilcable to their contract by express agreement, they may likewise render it inapplicable by implied agreement or by usage.' [Citation.]''

(Although Vice Chief Justice Struckmeyer felt the use of the words ''in trust'' created a trust fund in this case, he concurred in the result of the majority, denying payment for the usage of advance funds on the basis of the above rationale.) We believe that the plaintiff's intention and expectation with regard to the advance-payment provisions of the mortgage must be judged in light of the custom and usage of commingling the funds and of not paying interest or earnings thereupon. We conclude that plaintiffs have failed to make a showing that they intended to create an express trust of those advance funds.

We decline the plaintiffs' invitation to overlook deficiencies in their expressed intention on the basis that the contract herein was a contract of adhesion—a form con-

tract supplied by FHA and the mortgagee—the terms of which could be accepted or rejected, but not negotiated, by the plaintiffs. If there is need for the imposition of an unwritten contract term to impose a trust on these advance funds for the benefit of plaintiffs, we believe it is the proper function of the legislature to so determine. See *Surrey Strathmore Corp.* v. *Dollar Savings Bank* (1975), 36 N.Y.2d 173, 178, 325 N.E.2d 527, 530, 366 N.Y.S.2d 107, 110; *Carpenter* v. *Suffolk Franklin Savings Bank* (1976), ... Mass. ....., ..., 346 N.E.2d 892, 900. See also Ill. Rev. Stat. 1975, ch. 95, par. 101 *et seq.* (effective January 1, 1976).

We likewise reject plaintiffs' assertion that they have stated a claim for unjust enrichment. It has been pointed out that ''the absence of a provision to pay interest on the impoundment funds is equivalent to an agreement that it should not be paid. A person is not entitled to compensation on the grounds of unjust enrichment if he receives from the other that which it was agreed between them the other should give in return. Restatement of Restitution sec. 107, comment (1)a. Finally, where there is a specific contract which governs the relationship of the parties, the doctrine of unjust enrichment has no application.'' (*Brooks* v. *Valley National Bank* (1976), 113 Ariz. 169, 174, 548 P.2d 1166, 1171.) The above principles are applicable to the case at bar, and they are not altered by the finding of a mortgagee's fiduciary duty in *Janes* v. *First Federal Savings & Loan Association* (1974), 57 Ill. 2d 398. In that case, this court held the defendant breached a fiduciary duty owed to its creditor, for whom and with whose funds it purchased title insurance and then retained a rebate thereon from the insurer. The court observed that ''[m]ore is involved here, however, than a relationship of mortgagor and mortgagee 'of itself' * * *.'' (57 Ill. 2d 398, 408.)

Nothing in the specific relationship of the parties here suggests anything other than the customary mortgagor-mortgagee relationship. Although the breach of a fiduciary relationship may justify the imposition of a constructive trust, plaintiffs have failed to allege facts sufficient to establish the creation of a fiduciary relationship or a breach thereof.

Defendant's cross-appeal claims that the Federal Home Loan Bank has primary jurisdiction of this cause of action. We have reviewed the cases submitted for this proposition and find the contention to be without merit. In view of our disposition of the above issues, we do not reach the class action issue asserted by the defendant on cross-appeal.

For the above reasons, the judgments of the appellate and circuit courts are affirmed.

Judgments affirmed.

MR. JUSTICE DOOLEY, dissenting:

The majority commits the basic error of treating this appeal as if there had been a determination on the merits. While it describes defendant's motion as a "motion for judgment on the pleadings or in the alternative for summary judgment or in the alternative to dismiss" (68 Ill. 2d at 380), the order indicates that there was a judgment of dismissal.

A motion for judgment on the pleadings admits the truth of well-pleaded facts by the opposite party. (*Walker* v. *State Board of Elections* (1976), 65 Ill. 2d 543, 553; *Cunningham* v. *MacNeal Memorial Hospital* (1970), 47 Ill. 2d 443, 448; *Milanko* v. *Jensen* (1949), 404 Ill. 261, 265.) So also on a motion to dismiss we must consider as true all well-pleaded facts. (*Edgar County Bank & Trust Co.* v. *Paris Hospital, Inc.* (1974), 57 Ill. 2d 298, 305.) Since

the record is without evidence of summary judgment, and in view of the order entered, we must view this case as decided on a motion to dismiss.

The query then becomes, What facts do the plaintiffs seek to prove? Plaintiffs, as the majority indicates, own homes which are mortgaged to defendant on Federal Housing Authority (FHA) or Veterans Administration (VA) forms. The mortgages require mortgagors to make payments one month prior to the date when ground rents, insurance premiums, taxes and assessments will become delinquent, "such sums to be held by Mortgagee *in trust* to pay said ground rents, premiums, taxes and special assessments." (Emphasis added.)

The FHA regulations concerning this obligation provide that "such [advance] payments shall be *held* by the mortgagee * * * for the purpose of paying such ground rents, taxes, assessments, and insurance premiums * * * *for the benefit and account of the mortgagor.*" (Emphasis added.) (24 C.F.R. sec. 203.23 (1977).) Plaintiffs allege that the language in the agreement establishes an express trust, and that the FHA regulations and other requirements binding defendant contemplate a trust relationship in providing that supervised lenders must use such funds only for the purpose for which they were collected, namely, to pay bills for taxes, special assessments, ground rents and hazard insurance premiums.

Defendant, it is alleged, had a fiduciary duty to plaintiffs. Instead of accounting to plaintiffs for all earnings and proceeds made by the use of the funds deposited in trust, it has made profits through the investment of such funds in the operation of its business. In the alternative, plaintiffs contend that the defendant fraudulently con-

verted the earnings from these monies to its own use, commingled these funds with its general funds and was unjustly enriched as a result. Plaintiffs seek the declaration of a constructive trust as an alternative remedy.

The issue before us is rather simple: Does the complaint allege facts sufficient to state a cause of action for breach of an express trust or for the declaration of a constructive trust?

The complaint alleges that an express trust was created. The existence of such an express trust turns upon the nature of the specific agreement and all the facts before the court. See *Carpenter* v. *Suffolk Franklin Savings Bank* (1973), 362 Mass. 770, 779-80, 291 N.E.2d 609, 615-16; *Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 143-45, 320 A.2d 117, 122-23: Restatement (Second) of Trusts sec. 12, comment *g*, sec. 24 (1959).

The Restatement (Second) of Trusts sec. 12, comment *g* (1959), cited by the majority, states that the existence of a trust can be determined from the intention of the parties as ascertained by a consideration of their words and conduct in light of all the circumstances. But how can such intent be determined without learning the facts? This is the limbo in which we find ourselves when there has been a summary disposition on a motion to dismiss.

Plaintiffs' allegations indicate the presence of a trust. While the words "in trust" are not necessary to the creation of such a trust, yet they are employed here. (See *Carpenter* v. *Suffolk Franklin Savings Bank* (1973), 362 Mass. 770, 776, 291 N.E.2d 609, 614; *Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 143, 320 A.2d 117, 122; Restatement (Second) of Trusts sec. 24(2) and sec. 24, comment *b* (1959).) They must be given their common meaning. We cannot ignore clear contractual language. *Brooks* v. *Valley National Bank* (1976), 113 Ariz. 169, 175-76, 548 P.2d 1166, 1172-73 (Vice Chief Justice Struckmeyer, specially concurring).

It would seem that the payments were designated by both mortgagor and mortgagee for a specific purpose—the payment of ground rents, taxes, assessments and insurance premiums. Where a mortgagor makes payments to a mortgagee with the express purpose that the funds shall be used for a particular purpose, then such funds may be considered held by the mortgagee in trust. 1 A. Scott, Trusts sec. 24, at 192 (3d ed. 1967), observed: "Where the owner of property transfers it to another with a direction to transfer it to * * * a third person, this may be a sufficient manifestation of an intention to create a trust."

In *Andrew* v. *Union Savings Bank & Trust Co.* (1935), 220 Iowa 712, 715, 263 N.W. 495, 497, where a bank agreed to hold certain sums pending the outcome of an attachment suit, it was observed: "[T]he money does not become the property of the bank. The fund is merely intrusted to the bank as a trustee or bailee without any authority on the part of the bank to use it as its own."

In the oft-quoted *In re Interborough Consol. Corp.* (2d Cir. 1923), 288 F. 334, 347, the court observed: "There are certain principles we regard as established: * * * Every person who receives money to be paid to another, or to be applied to a particular purpose, to which he does not apply it, is a trustee, and may be sued either at law for money had and received, or in equity as a trustee, for a breach of trust." It is well established that the transfer of funds to a bank with the express purpose that they be used for a specified purpose lends support for the existence of a trust. *Carpenter* v. *Suffolk Franklin Savings Bank* (1973), 362 Mass. 770, 777, 291 N.E.2d 609, 614;

Buchanan v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 147-48, 320 A.2d 117, 124; 1 A. Scott, Trusts sec. 24, at 192 (3d ed. 1967); see Comment, *Payment of Interest on Mortgage Escrow Accounts: Judicial and Legislative Developments,* 23 Syracuse L. Rev. 845, 852 (1972).

Despite the strained interpretation given the language by the majority (slip op. at 5), FHA regulation (24 C.F.R. sec. 203.23 (1977)) provides the advance payments in question are to be held by the mortgagee for the purpose of paying certain obligations for the benefit of the mortgagor. All this leads to the conclusion that the complaint stated a cause of action for an express trust.

In this posture of the case there are present the essentials of a trust, namely, a fund, title in the trustee, a trustee and a well-defined beneficiary, as Mr. Justice Wachtler graphically points out in his opinion in *Surrey Strathmore Corp.* v. *Dollar Savings Bank* (1975), 36 N.Y. 2d 173, 179-80, 325 N.E.2d 527, 531 (Wachtler, J., dissenting).

That the bank may not have subjectively intended to create a trust relationship, as evidenced by the common practice to distribute no earnings or interest on such advance funds, is not conclusive of the issue. In the law of trusts, as in the law of contracts in general, it is the external manifestation of intent which is controlling. (Restatement (Second) of Trusts sec. 2, comment *g,* sec. 23, comment *a* (1959).) A trier of fact might reasonably conclude that the mortgage agreement and whatever other facts are adduced in a hearing on the merits indicate the presence of a trust relationship. The mortgagors who signed the form mortgage contracts presumably read the agreement.

The FHA insures mortgages on homes. There is a dollar limitation on the amount of any particular home mortgage which may be guaranteed by it. At present that limit is $45,000 for owner-occupied, single-family residences. (12 U.S.C. sec. 1709(b)(2) (Supp. 1975); 24 C.F.R. 203.18 (1977).) Thus, persons who obtain FHA mortgages are purchasers of nonexpensive homes or are of limited means. Savings and loan associations are designed to promote home ownership. (Ill. Rev. Stat. 1975, ch. 32, par. 702(a); 12 U.S.C. sec. 1464(a) (1970).) It is a recognized fact that banks are not interested in investing in long-term mortgages. Hence, the only avenue to borrowers without particular stature at banks has been the savings and loan association, today a vital force in the supply of credit. This, of course, adds up to inequality of bargaining power, a circumstance we cannot disregard. The mortgagors in these FHA loans had no place to go but to the savings and loan lenders. They had to accept the mortgage on the savings and loan association's terms.

The majority noted that plaintiffs have not made a showing that they intended to create an express trust (68 Ill. 2d 390). But there has been no opportunity to do so, and the majority would foreclose such an occasion. Further analysis is idle. The complaint stated sufficient allegations to put in issue the creation of a trust and consequent imposition of fiduciary duties. *Carpenter* v. *Suffolk Franklin Savings Bank* (1973), 362 Mass. 770, 291 N.E.2d 609; *Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 320 A.2d 117; Note, *Lender Accountability and the Problem of Noninterest-bearing Mortgage Escrow Accounts,* 54 Boston U.L. Rev. 516, 524 (1974).

Plaintiff's alternate contention is that the profits defendant earned through use of their funds should be impressed with a constructive trust for their benefit.

A constructive trust can arise where there is either actual fraud or implied fraud resulting from the breach of a confidential relationship. (*Hofert* v. *Latorri* (1961), 22 Ill. 2d 126, 130; *Carroll* v. *Caldwell* (1957), 12 Ill. 2d 487, 493-94.) This court has recognized that the mortgagor-mortgagee relationship can be fiduciary in character. (*Janes* v. *First Federal Savings & Loan Association* (1974), 57 Ill. 2d 398.) Where the loan agreement provides for a specific disposition of a sum of money, a fiduciary relationship may arise. Where the mortgagee uses the money for a purpose other than that authorized and for its own gain, the mortgagee breaches its fiduciary duty. In holding that the complaint stated a cause of action, the *Janes* court quoted from the Restatement of Restitution, section 197 (1937):

> "Where a fiduciary in violation of his duty to the beneficiary receives or retains a bonus or a commission or other profit, he holds what he receives upon a constructive trust for the beneficiary."

Plaintiffs are entitled to prove their claim for the declaration of a constructive trust based on the breach of the fiduciary relationship created by the mortgage agreement. More is involved here than a relationship between a mortgagor and a mortgagee. There is also an agreement to hold money in trust for the purpose of paying obligations of the mortgagor. Should the trial result in a finding that there is no express trust, there could be found a constructive trust based on the mortgage agreement.

There is no inconsistency between these two theories. (See *Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 320 A.2d 117.) The plaintiffs are not seeking both to enforce a contractual provision concerning interest and to receive restitution for unjust

enrichment. They are seeking alternative relief. If there is no binding express trust, then, the complaint alleges, in the alternative, there is a constructive trust. The language quoted by the majority from *Brooks* v. *Valley National Bank* (1976), 113 Ariz. 169, 174, 548 P.2d 1166, 1171, is not germane.

A constructive trust is raised by equity to require a party to disgorge retained funds on the ground that their retention is wrongful and unjustly enriches the holder. (Restatement of Restitution sec. 160 (1937); Restatement (Second) Trusts sec. 1, comment *e* (1959); See Comment, *Payment of Interest on Mortgage Escrow Accounts: Judicial and Legislative Developments,* 23 Syracuse L. Rev. 845, 852 n.43 (1972).) As the Pennsylvania Supreme Court noted, in deciding a similar case:

> "It is rare that the existence or absence of justification for imposing an equitable remedy, especially a constructive trust, can be decided as a matter of law. Only after all the facts are before a court, can it in most cases properly determine the issue. * * *
>
> * * * The evil to be avoided is unfairness and inequality in bargaining or dealings between parties." *Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 152-53, 320 A.2d 117, 127.

Whether there is an express trust or constructive trust cannot be determined by a court on a motion to dismiss. Whether the plaintiffs will be successful on a trial we do not know, but simple justice dictates that under the facts and circumstances here they be given a hearing. Nor do we stand alone. Such reputable jurisdictions as Pennsylvania (*Buchanan* v. *Brentwood Federal Savings & Loan Assoc.* (1974), 457 Pa. 135, 320 A.2d 117) and Massachusetts (*Carpenter* v. *Suffolk Franklin Savings Bank* (1973),

362 Mass. 770, 291 N.E.2d 609) have both decided that under similar circumstances it was error to preclude a trial. It is worthy of note that these authorities are not alluded to in the majority opinion.

I would reverse the judgment of the appellate court and afford plaintiffs the opportunity to prove their case. Only then will the intangibles of these issues become realities. In my opinion, summary dispositions can be destructive of substantial rights in certain instances. This is one of them.

WARD, C.J., and GOLDENHERSH, J., join in this dissent.

APPENDIX II

OPINION OF THE APPELLATE COURT

Mr. JUSTICE McGLOON delivered the opinion of the court:

In this case, we are asked to consider the question of whether individuals representing a class of mortgagors are entitled to maintain an action against their mortgagee for interest earned by the mortgagee on the mortgagors' advance payments to the mortgagee for taxes, assessments, and insurance. Plaintiffs-mortgagors, Ernest and Mary LaThrop, filed suit in the circuit court of Cook County against their mortgagee, Bell Federal Savings and Loan Association, asking for an accounting of such wrongfully appropriated earnings. The trial court granted defendant's motion to dismiss, and this appeal was taken by plaintiffs.

We affirm.

The pertinent facts are as follows. On May 2, 1969, plaintiffs secured a mortgage loan from Bell. The mortgage was in a form prescribed by the Federal Housing Authority, which guaranteed the loan. By the terms of the mortgage, plaintiffs promised:

> "That, together with, and in additon to, the monthly payment of principal and interest payable under the terms of the note secured hereby, the Mortgagor will pay to the Mortgagee, on the first day of each month until the said note is fully paid, the following sums:
>
> (a) An amount sufficient to provide the holder hereof with funds to pay the next mortgage insurance premium if this instrument and the note secured hereby are insured, or a monthly charge (in lieu of a mortgage insurance premium) if they are held by the Secretary of Housing and Urban Development, as follows:

(I) If and so long as said note of even date and this instrument are insured or are reinsured under the provisions of the National Housing Act, an amount sufficient to accumulate in the hands of the holder one (1) month prior to its due date the annual mortgage insurance premium, in order to provide such holder with funds to pay such premium to the Secretary of Housing and Urban Development pursuant to the National Housing Act, as amended, and applicable Regulations thereunder, or

(II) If and so long as said note of even date and this instrument are held by the Secretary of Housing and Urban Development, a monthly charge (in lieu of a mortgage insurance premium) which shall be in an amount equal to one-twelfth (1/12) or one-half (½) per centum of the average outstanding balance due on the note computed without taking into account delinquencies or prepayment;

(b) A sum equal to the ground rents, if any, next due, plus the premiums that will next become due and payable on policies of fire and other hazard insurance covering the mortgaged property, plus taxes and assessment next due on the mortgaged property (as estimated by the Mortgagee) less all sums already paid therefor divided by the number of months to elapse before one month prior to the date when such ground rents, premiums, taxes and assessments will become delinquent, such sums to be held by Mortgagee in trust to pay said ground rents, premiums, taxes and special assessments; and

(c) All payments mentioned in the two preceding subsections of this paragraph and all payments to be made under the note secured hereby shall be added together and the aggregate amount thereof shall be paid by the Mortgagor each month in a single payment to be applied by the Mortgagee to the following items in the order set forth;

(I) Premium charges under the contract of insurance with the Secretary of Housing and Urban Development, or monthly charge (in lieu of mortgage insurance premium), as the case may be;

(II) Ground rents, if any, taxes, special assessments, fire and other hazard insurance premiums;

(III) Interest on the note secured hereby; and

(IV) Amortization of the principal of the said note."

We are concerned with section (b), which provides that plaintiffs-mortgagors will make monthly advance payments for ground rents, hazard insurance premiums, taxes and assessments to Bell, "such sums to he held by Mortgagee in trust to pay said ground rents, premiums, taxes and special assessments * * *."

Plaintiffs contend that the language in section (b) created a trust, and that Bell violated its trust duties by commingling the trust funds with its general funds, using the funds in its operations, earning money through the use of the trust funds, and appropriating the earnings for itself. In the alternative, plaintiffs contend that Bell should be declared a constructive trustee of the funds for the benefit of plaintiffs and the class they represent. Defendant admits that it commingles the funds, denies that it is a trustee, and contends that it has the legal right to treat the funds as its own.

● 1, 2 The first issue on appeal is whether an express trust was created in the motrgage by the language requiring that the funds are "to be held by the Mortgagee in trust to pay * * *." Plaintiffs' basic position is that the clear language of the instrument leaves no room for construction, and that the "in trust" provision in the FHA form mortgage has been held to create a trust. Defendant

argues that (1) the mortgage language is inconsistent with the creation of a trust; (2) the intention of the parties to create a trust is lacking; (3) the Bank is not required by law to either segregate the advance payments or pay earnings to mortgagors; and (4) at most, the advance payments are general deposits for a special purpose which do not create a trust.

The first Illinois case to consider the question of whether an express trust may be found to exist with regard to a mortgagor's advance payments for taxes and insurance is *Sears* v. *First Federal Savings & Loan Association* (1971), 1 Ill. App. 3d 621, 275 N.E.2d 300, 50 A.L.R.3d 683. Therein, the mortgagors argued that the clear language of that mortgage controlled. Of this argument, this court stated:

> "* * * we must examine all of the pertinent language of the note itself as above quoted. We cannot give effect to portions of the note only. Each clause and all of the language used must, if possible, be given meaning, life and effect. * * * In addition, we must consider the background of the transaction before the court." (1 Ill. App. 3d 621, 627.)

Although the mortgage language in *Sears* is substantially different than the unqualified "in trust to pay" provision in the instant case, the above stated rule is applicable. It is also clear that the use or nonuse of the words "in trust" "is not the controlling criteria as to whether an express trust has or has not been created." (*Oglesby* v. *Springfield Marine Bank* (1946), 395 Ill. 37, 49; Restatement (Second) of Trusts §24(2) (1959).) The question of law arising in such a case is "whether the settlor manifested an intention to impose upon himself or upon a transferee of the property, equitable duties to deal with the property for the benefit of another person," which is in effect "whether the settlor manifested an intention to create the kind of relationship which to lawyers is known as a trust." 1 Scott, Law of Trusts §24, at 192 (3d ed. 1967).

Bell argues that the mortgage language is inconsistent with the creation of a trust, citing *Sears*. The first inconsistency noted is that the mortgagors made *payments* to the mortgagee, and the concept of payment is inconsistent with a trust relationship. The court in *Sears* stated:

> "Webster's Second New International Dictionary defines the verb 'to pay' as 'to discharge one's obligation.' Under the note here involved, the debtor makes a payment and receives simply and only *pro tanto* satisfaction of his debt. * * * All that we have here from the language of this note is a binding direction imposed upon defendant as a creditor concerning payment of taxes and insurance." (1 Ill. App. 3d 621, 629.)

Bell's theory is that the payments were merely a part of the debtor-creditor relationship which existed between the parties with respect to the advanced funds for the ultimate payment of taxes and insurance premiums. A contrary interpretation was made by the Pennsylvania Supreme Court in *Buchanan* v. *Brentwood Federal Savings & Loan Association* (1974), 457 Pa. 135, 150, 320 A.2d 117, 125, which felt that such a construction of "pay" was hypertechnical, and not in keeping with the reading of the agreement as a whole, stating that "the word 'pay' was used generically to mean tender, hand over, or deliver."

● 3 The second inconsistency argued by Bell is that the mortgage document does not require the segregation or isolation of the advanced funds, which tends to show that a trust was not intended. *Sears* held that the absence of terms requiring the segregation of funds showed a "lack of direction and intent" that the funds were to be held in trust as a special deposit. (1 Ill. App. 3d 621, 628.) Of the lack of segregation, one commentator wrote:

> "The court's reasoning [in *Sears*], however assumes its conclusion that no trust exists; for, if the escrow funds were intended to be held in trust, then the bank's failure to segregate the funds would indicate the bank's breach of that trust rather than demonstrate that no trust was present." (Note, *Lender Accountability and the Problem of Noninterest-Bearing Mortgage Escrow Accounts,* 54 Boston U.L. Rev. 516, 524 (1974).)

Neither alleged inconsistency is controlling on the issue because the real question, of course, is whether the mortgagors intended to create a trust, notwithstanding that they may not have known "the precise characteristics of the relationship which is called a trust." 1 Scott, Law of Trusts §23, at 191.

● 4, 5 The first element necessary for the creation of an express trust is an explicit declaration of trust, or circumstances which show that a trust was intended to be created. If an intention to create a trust can be fairly collected from the language of the instrument in question, the courts will give effect to that intention. (*Stowell* v. *Satorius* (1952), 413 Ill. 482, 492.) No particular form or words are necessary to create a trust. (*Goldstein* v. *Handley* (1945), 390 Ill. 118.) As this court stated generally in *Williams* v. *Teachers Insurance & Annuity Association* (1973), 15 Ill. App. 3d 542, 546: "Equity looks to the substance rather than the form; if a trust was created it does not matter whether it is designated accurately, inaccurately or not at all." Some of the considerations for identifying the intention to create a trust are set forth in 89 C.J.S. *Trusts* §43, at 776 (1955):

> "* * * the intention may be gathered from powers granted and duties imposed and from manifest purposes which cannot be accomplished except through a trust, or from the relationship of the parties and acts affecting the title to, and possession of, the trust property."

● 6 We now turn to a consideration of the mortgage agreement before us and the transaction of which it is a part. Plaintiffs borrowed money from defendant to purchase a home, and gave a mortgage on their home to defendant as security. The mortgage was guaranteed by the Federal Housing Authority. Under the mortgage agreement, the mortgagors remained primarily liable for the payment of insurance premiums, taxes, and assessments on the mortgaged property. The mortgagee required, however, that the mortgagors pay to it a certain amount every month so that the mortgagee could make the payments when these obilgations became due. Should the mortgagors refuse or neglect to make the advance payments for these obligations to the mortgagee, the mortgagee was entitled to pay such obligations itself and tack the amount so expended onto the mortgagors' indebtedness.

The mortgagee is allowed by law to require such monthly payments. (12 C.F.R. §545.6—11.) The origins of this practice were explained in a recent case:

> "In the 1930's substantial numbers of foreclosures were caused by inability to pay annual assessments. As a result of this, banks began requiring the monthly tax payments. The theory was that individual homeowners, especially small borrowers, would find it easier to make monthly payments of one-twelfth the yearly taxes, than to meet in a single payment the annual bill. The practice has continued ever since." (*Buchanan* v. *Brentwood Federal Savings & Loan Association* (1974), 457 Pa. 135, 141, 320 A.2d 117, 121.)

(See generally Note, *Lender Accountability and the Problem of Noninterest-Bearing Mortgage Escrow Accounts,* 54 Boston U.L. Rev. 516 (1974); Note, *The Attack Upon the*

Tax and Insurance Escrow Accounts in Mortgages, 47 Temp. L.Q. 352 (1974); and Note, *The Real Estate Escrow Account—Recent Trends Toward Reform,* 10 Ga. State B.J. 618 (1974).) The primary purpose of the monthly payments is to serve as an additional security device for the protection of the mortgagee savings and loan association's interest in the mortgaged property. The mortgagee knows that if these obligations are satisfied in a timely fashion, its interest in the mortgaged property or its proceeds would not be impaired. Should the property be destroyed by fire, the mortgagee would be protected by the proceeds of a valid insurance policy. Similarly, by making sure the taxes and assessments are paid, the mortgagee protects itself from a tax sale of the property and the subordinate role the mortgagee must take to the taxing body.

• 7 The question, however, is whether the mortgagors intended to retain such an interest in the money given to the mortgagee as would be consistent with the creation of an express trust. Many courts which have dealt with similar cases have ruled that as a matter of law, the mortgagor relinquishes all control over the money when it is tendered to the mortgagee. It has been held that should a mortgagor be declared bankrupt, the trustee in bankruptcy could not recover the funds from the mortgagee, even where the mortgage stated that the mortgagee "shall hold such monthly payments in trust * * *." The court in *In re Simon* (E.D. N.Y. 1958), 167 F. Supp. 214, 215, wrote that such funds "are no longer within the control or jurisdiction of the bankrupt." In *Central Suffolk Hospital Association* v. *Downs* (1961), 213 N.Y.S.2d 192, the mortgagor's judgment creditor attempted to reach the funds which, under the terms of a similar FHA mortgage, were to be held by the mortgagee "in trust to pay." The court wrote:

> "The funds paid by the judgment debtors under the foregoing provisions are no longer under their control and consequently they would have no right to demand or recover same from the mortgagee." (213 N.Y.S.2d 192, 194.)

(See also *Valerio* v. *College Point Savings Bank* (1965), 264 N.Y.S.2d 343 48 Misc. 2d 91.) We have reached similar conclusions. In *Sears* v. *First Federal Savings & Loan Association,* the court wrote:

> "When the payments were made, the borrowers retained no specific property rights in any of the sums thus paid. They retained no right to refund of any portion of any payment. The payment was unconditional except for a contractual right vested in the borrower to have the taxes and insurance paid to the extent of the total of the monthly payments. Plaintiff had no property rights beyond this in any payment after it was made." (1 Ill. App. 3d 621, 631.)

In *Durkee* v. *Franklin Savings Association* (1974), 17 Ill. App. 3d 978, 982, 309 N.E.2d 118, the Second District Appellate Court held:

> "Plaintiffs' mortgage agreement is devoid of any language that would allow them to receive back any or all of their monthly partial tax and insurance payments after such sum is paid to defendant."

• 8 In the instant case, the mortgage does not contain any language from which we can discern the mortgagors' intention to retain any rights in the funds which would be consistent with the creation of an express trust. The mortgagee is not impressed with any duty whatsoever to do anything with the money except to use it to pay the taxes, assessments, and hazard insurance premiums when they become due and owing. (See *Boyce* v. *National Commercial Bank & Trust Co.* (1964), 247 N.Y.S.2d 521, 41 Misc. 2d 1071.) Absent the showing of the plaintiffs' intention to

place an affirmative duty upon defendant to care for the funds as a trustee, an express trust cannot be proven in this case under the complaint before us. Although plaintiffs call to our attention the various Federal and State laws, regulations, and guides which govern the operation of savings and loan associations, we have not been able to find any provision which states that a supervised lending institution such as Bell has the affirmative duty to act as a trustee with regard to these advanced funds. *Gibson* v. *First Federal Savings & Loan Association* (6th Cir. 1974), 504 F.2d 826, 829.

• 9 Plaintiffs cite two cases from courts in other jurisdictions which have held, under similar facts, that the mortgagor has sufficiently put in issue the creation of an express trust. In both cases, *Buchanan* v. *Brentwood Federal Savings & Loan Association* (1974), 457 Pa. 135, 320 A.2d 117, and *Carpenter* v. *Suffolk Franklin Savings Bank* (1973), 362 Mass. 770, 291 N.E.2d 609, the underlying theory was that funds deposited with a bank to be used for a special purpose constitute trust funds.

> "Where the mortgagor pays funds to a bank with an expressed purpose that the funds shall be used for a particular purpose, then the funds may be deemed to be held in trust." (362 Mass. 770, 777, 291 N.E.2d 609, 614; quoted in *Buchanan,* 457 Pa. 135, 147, 320 A.2d 117, 124.)

Illinois courts have consistently held that the relationship between the parties in a case of this type arises when the mortgage agreement is entered into, and not when the mortgagor makes his first payment to the mortgagee. The court in *Durkee* v. *Franklin Savings Association* (1974), 17 Ill. App. 3d 978, 981-82, discussing Illinois cases on deposits for a special purpose, wrote:

> "Both cases involve true deposit relationships—a contractual relationship between the depositor and the depositary bank which arises from the *delivery* of money by the depositor into the possession of the bank. 10 Am. Jur. 2d *Banks,* sec. 337.
>
> The contractual relationship between plaintiffs and defendant Franklin Savings Association, however, did not arise upon the delivery of the first monthly real estate and insurance premium payments to defendant. Rather, the contractual relationship between plaintiffs and defendant arose upon plaintiffs' execution of the mortgage agreement wherein they promised 'to pay' the required monthly amounts to defendant."

In *Oddo* v. *Western Savings & Loan Association* (1974), 17 Ill. App. 3d 276 (abstract opinion), we ruled that the prepayments were not deposits in a legal sense. The cases cited by plaintiffs are contrary to Illinois law in this regard, and are not authority for the proposition that plaintiffs herein intended to create an express trust.

Accordingly, the trial court did not err in dismissing that portion of plaintiffs' complaint which alleged the creation of an express trust as to the funds held by defendant.

• 10 In the alternative, plaintiffs' complaint prays for the imposition of a constructive trust upon Bell's earnings on the advance payments. It is alleged that defendant fraudulently converted the earnings for its own use and commingled the earnings with its general funds. Plaintiffs conclude that defendant was unjustly enriched and should be declared a constructive trustee of the earnings.

Constructive trusts are divided into two general classes: "one where actual fraud is considered as an equitable ground for raising the trust, and the other where there is a confidential relationship and the subsequent abuse of the confidence reposed." (*Dial* v. *Dial* (1959), 17 Ill.2d 537, 162

N.E.2d 404, 406.) The complaint at bar alleges a bare fraudulent conversion of earnings, but does not specifically allege facts to show how the fraud was perpetrated. The defendant openly admits that it treats the earnings as its own, contending that it has a right to do so. At best, there is a dispute as to the competing interests in the earnings; we fail to see the fraud which must be clearly alleged to state a cause of action for the imposition of a constructive trust.

• 11 The other type of constructive trust arises when a confidential relationship is abused. Plaintiffs call our attention to the decision in *Janes* v. *First Federal Savings & Loan Association* (1974), 57 Ill.2d 398. In *Janes,* the mortgagors-borrowers authorized their mortgagee-lender to order a title insurance policy for them and to pay for the policy from the loan proceeds. The mortgagee purchased the policy and charged the mortgagors, but also received a 10% discount or rebate from the title insurance company which the mortgagors sought to recover under a constructive trust theory. The language utilized by our supreme court deserves careful attention:

> "The appellate court then considered the possibility of the existence and breach of a trust, but rejected any right to recover on such a theory on the ground that 'the relationship of mortgagor and mortgagee does not of itself show the existence of a confidential or fiduciary relationship.' More is involved here, however, than a relationship of mortgagor and mortgagee 'of itself,' and in our opinion count I of the complaint alleges a fiduciary relationship. The loan statement attached to the complaint is an accounting by Berwyn for its disposition of the money which the plaintiffs had borrowed from it. The statement recites the amount borrowed by the plaintiffs, and it contains their authorization to Berwyn to make specific dispositions of that sum of money. Any disposition of those funds for a purpose other than as authorized by the plaintiffs was improper and a violation by Berwyn of the duty which it owed to the plaintiffs." (57 Ill. 2d 398, 408-09.)

The plaintiffs herein submit that *Janes* is direct authority for the conclusion that Bell is their fiduciary because more is involved than a mortgagor-mortgagee relationship. A close examination of *Janes* along traditional legal lines of analysis shows that the cases are distinguishable. The usual test for the existence of a fiduciary relationship is whether a special trust or confidence has been reposed by an innocent party. (*Tarpoff* v. *Karandjeff* (1964), 51 Ill. App. 2d 454, 201 N.E.2d 549.) In *Janes,* the particular arrangement of authorizing disbursement for the cost of a title insurance poilcy necessarily involved confidence reposed in the lender-mortgagee, the confidence that the lender would not pay out more than was authorized. By the lender paying out the stated policy cost knowing full well that the actual cost was lower because of the rebate, the relationship of confidence with respect to the payouts was abused. In our case, the plaintiffs' complaint does not allege any facts showing a relationship of special trust or confidence as in *Janes.* To assert on appeal only that there is more than the usual mortgagor-mortgagee relationship is to disregard the well-known rules pertaining to the establishment of fiduciary relationships.

• 12 In light of our ruling, we need not consider the class action aspects of this case. *Zelickman* v. *Bell Federal Savings & Loan Association* (1973), 13 Ill. App. 3d 578, 301 N.E.2d 47.

For the above-mentioned reasons, the judgment of the circuit court of Cook County dismissing plaintiffs' complaint for failure to state a cause of action is affirmed.

Judgment affirmed.

DEMPSEY and McNAMARA, JJ., concur.

APPENDIX III

SUPREME COURT OF ILLINOIS

ORDER

Petition for Rehearing was filed, but Denied on November 23, 1977.